DOCUMENT RESUME

ED 322 267 UD 027 567

AUTHOR	Greenstein, Robert; Barancik, Scott
TITLE	Drifting Apart: New Findings on Growing Income Disparities Between the Rich, the Poor, and the Middle Class.
INSTITUTION	Center on Budget and Policy Priorities, Washington, DC.
PUB DATE	Jul 90
NOTE	25p.
AVAILABLE FROM	Center on Budget and Policy Priorities, 777 N. Capitol Street, NE, Suite 705, Washington, DC 20002.
PUB TYPE	Reports - Research/Technical (143)
EDRS PRICE	MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS	*Family Financial Resources; *Income; Low Income Groups; Middle Class; *Social Stratification; Socioeconomic Status; *Tax Effort; *Taxes; Trend Analysis
IDENTIFIERS	*Income Disparities; Proposed Legislation

ABSTRACT

Income disparities between wealthy and other Americans widened significantly in the 1980s. The most affluent Americans reaped exceptionally large income gains during that decade, while middle-income Americans gained little, and low-income Americans fell further behind. The richest one percent of all Americans now receive as much income after taxes as the bottom 40 percent of Americans combined. The share of national income going to middle-income Americans is now lower than at any time since the end of World War II. One factor behind these widening income disparities is a striking increase in the amount of capital gains income received by the wealthiest Americans. In 1990, households in the top 1 percent of the population are projected to receive an average of $175,000 in capital gains income. This is $92,000 more than they received in 1980, after adjusting for inflation. By contrast, those in the bottom 90 percent of the population are projected to receive average capital gains income of $300 this year, just $12 more than in 1980. A reduction in capital gains taxes would widen these already large income disparities still further. A shift in Federal tax burdens has also contributed to the growing disparities. Wealthy households now pay a smaller percentage of their income in taxes than they did in 1980; lower income households now pay a larger proportion. The trend toward income disparities is a relatively recent phenomenon. Between 1950 and 1970, income disparities narrowed. This pattern reversed itself in the 1970s, as disparities began to grow modestly. Disparities then grew more sharply in the 1980s. Statistical data are included on three tables and two graphs. A comparison of changes in income distribution between 1980 and 1990 and two tables of statistical data are appended. (EMW)

Drifting Apart

New Findings on Growing Income Disparities Between the Rich, the Poor, and the Middle Class

Center on Budget and Policy Priorities
Washington, D.C.

Drifting Apart

New Findings on Growing Income Disparities Between the Rich, the Poor, and the Middle Class

Robert Greenstein
Scott Barancik

Center on Budget and Policy Priorities
Washington, D.C.

The Center on Budget and Policy Priorities, located in Washington, D.C., is a nonpartisan, nonprofit research organization that studies government spending and the programs and public policy issues that have an impact on low income Americans. The Center is funded by grants from foundations.

About the Authors

Robert Greenstein is the founder and director of the Center on Budget and Policy Priorities. A former administrator of the Food and Nutrition Service in the U.S. Department of Agriculture, he has written extensively on domestic public policy, budget issues, and poverty.

Scott Barancik is a research analyst at the Center on Budget and Policy Priorities. He is the author of two recent Center reports on affordable housing for the poor and the co-author of various studies on poverty trends.

July 1990

Center on Budget and Policy Priorities
777 N. Capitol Street, N.E. Suite 705
Washington, D.C. 20002
(202) 408-1080

Contents

Figures & Tables

Preface

In June 1990, the House Committee on Ways and Means published a 1,500 page volume of background material and data tables on matters ranging from Social Security and Medicare to recent trends in income distribution. The volume (popularly known as "The Green Book") includes an extensive series of data tables prepared by the Congressional Budget Office on recent trends in the distribution of income and on changes in federal tax burdens among various income groups.

The CBO data tables represent one of the most detailed data sets now available on such trends. The tables are based on data from four sources: the Current Population Survey conducted annually by the Census Bureau; Statistics of Income data compiled by the Internal Revenue Service each year from an extensive sample of individual income tax returns; the Consumer Expenditure Survey conducted by the Bureau of Labor Statistics; and the National Income and Product Accounts.

The publication of these data tables makes an important new resource available to analysts. This analysis is based primarily on the CBO data tables.

Overview

An analysis of recently released data on income trends in the 1980s shows that income disparities between wealthy and other Americans have widened significantly. The most affluent Americans reaped exceptionally large income gains during that decade, while middle income Americans gained little and low income Americans fell further behind.

As a result of these trends, the richest one percent of all Americans now receive nearly as much income after taxes as the bottom 40 percent of Americans combined. Stated another way, the richest 2.5 million people now have nearly as much income as the 100 million Americans with the lowest incomes.

Furthermore, the share of national income going to those in the middle of the income scale is now lower than at any time since the end of World War II.

One factor behind these widening income disparities is a striking increase in the amount of capital gains income received by the wealthiest Americans. In 1990, households in the top one percent of the population are projected to receive an average of $175,000 in capital gains income. This is $92,000 more than they received in 1980, after adjusting for inflation.

By contrast, those in the bottom 90 percent of the population (i.e., all American households except those in the top 10 percent) are projected to receive average capital gains income of $300 this year, just $12 more than in 1980. A reduction in capital gains taxes would widen these already large income disparities still further.

Another factor contributing to growing income disparities has been a shift in federal tax burdens. Wealthy households now pay a smaller percentage of their income in taxes than they did in 1980. Lower income households now pay a larger proportion.

The trend toward widening income disparities has not been a feature of American life for a long period of time; to the contrary, it is a relatively recent phenomenon. Between 1950 and 1970, income disparities narrowed. This pattern reversed itself in the 1970s, as disparities began to grow modestly. Disparities then grew more sharply in the 1980s.

The data tables on which this analysis is based were compiled by the Congressional Budget Office and issued as part of a 1,500 page volume of data tables and other material released last month by the House Committee on Ways and Means.[1]

Changes During the 1980s in Before-Tax Incomes

The 1980s were marked by great disparities in how various groups in the population fared.[2]

- The Congressional Budget Office projects that between 1980 and 1990, the average income (before taxes) of the wealthiest one-fifth of U.S. households will increase by more than $24,000 per household, after adjusting for inflation.[3] This represents a 30 percent increase. (See Table I.)

- Over the same period, the richest five percent of households will secure an average income gain of $64,000 per household, or 45 percent.

- The increases have been greatest at the very top of the income scale. The average income of the richest one percent of households will rise $236,000 from 1980 to 1990, an increase of 75 percent. These households will have average incomes of $549,000 in 1990, up from $313,000 in 1980.

---

[1]The data compiled by CBO are found in Committee on Ways and Means, U.S. House of Representatives, *Overview of Entitlement Programs: Background Material and Data on Programs Within the Jurisdiction of the Committee on Ways and Means*, (The Green Book), June 1990, pp. 1159-1206.

[2]In this analysis, we use the years 1980 and 1990 as our comparison points in examining changes in income distribution during the 1980s. Most of the CBO data reflected in this report are available for four years: 1977, 1980, 1985, and 1990.

When income shifts from 1977 to 1990 are studied, the results are similar to those for the period between 1980 and 1990. For further description of these similarities, see Appendix.

[3]CBO uses the term "families" to describe the income units in its data tables. Since the CBO data also include people living alone, however, we chose the term "households." That is the term the Census Bureau uses to describe income units of one or more people.

Table I
Changes in Average Before-Tax Household Incomes, 1980-1990,
By Various Income Groups

National income category	1980	1990 (projected)	change: 1980-90 ($)	change: 1980-90 (%)
Poorest tenth	$ 5,134	$ 4,695	$ -439	-8.6%
Poorest fifth	8,031	7,725	-306	-3.8
Next poorest fifth	19,088	19,348	260	1.4
Middle fifth	30,047	30,964	917	3.1
Next richest fifth	41,640	44,908	3,268	7.8
Richest fifth	81,041	105,209	24,168	29.8
Richest five percent	$ 142,306	$ 206,162	$ 63,856	44.9%
Richest one percent	313,206	548,969	235,763	75.3

Source: Congressional Budget Office

- By contrast, average income has changed little for households in the middle fifth of the income spectrum, rising just three percent -- or $900 -- from 1980 to 1990. This represents an average annual gain of just 0.3 percent, or $90, after adjusting for inflation. These households had average incomes of just over $30,000 in 1980 and will have average incomes of just under $31,000 in 1990.

- Households at the bottom have lost ground. The average income of households in the bottom fifth will decline four percent from 1980 to 1990, falling to $7,725. The incomes of households in the bottom tenth will drop nine percent, to $4,700.[4]

---

[4]The CBO figures are based on actual data for 1980 through 1988 and projections for 1989 and 1990 based on estimated growth rates in population, income, and expenditures. The CBO figures are based primarily on Census data, but reflect a somewhat broader measure of household income than Census data do. For example, CBO has adjusted the Census data on before-tax household income to include the employer share of the Social Security payroll tax as well as a share of the corporate income tax. CBO assumes that these taxes are ultimately borne by individual taxpayers -- either by employers, in terms of lost income, or by employees, in lower wages.

In addition, CBO assigns households to income quintiles in a somewhat different manner than the Census Bureau traditionally does. The Census Bureau divides all households into five groups with equal numbers of households. The 20 percent of households with the lowest incomes

(continued...)

Capital Gains: A Source of Growing Income Disparities

As a result of these developments, the share of before-tax income going to those at the top of the income scale has risen considerably, while the share of income going to poor and middle class Americans has declined. The CBO data point to one of the principal reasons for this trend: large increases in the amount of capital gains income received by very wealthy households.

As noted, the average income of the richest one percent of households will rise $236,000 from 1980 to 1990, after adjusting for inflation. The CBO data reveal that nearly 40 percent of this large increase is due to a sharp rise in capital gains income.

- In 1980, the average household in the top one percent had $83,000 in capital gains income. CBO projects that in 1990, households in the top one percent will have capital gains income averaging more than $175,000 -- or more than double the level in 1980, after adjusting for inflation. For households in the top one percent of the population, average annual capital gains income thus will rise *more than $92,000* from 1980 to 1990. (See Table II.)

- For other Americans, the picture is quite different. For households in the bottom 90 percent of the population (i.e., all households except those in the richest 10 percent), average annual capital gains income will rise *just $12* from 1980 to 1990, according to the CBO projection. The average household in the bottom 90 percent of the population had $287 in capital gains income in 1980 and will have $299 in 1990.[5]

---

[4](...continued)

become the bottom quintile, and the 20 percent with the highest incomes become the top quintile. CBO, on the other hand, recognizing that larger households have greater income needs than smaller households, adjusts each household's income according to the household's size before assigning the household to a quintile. CBO's quintiles contain equal numbers of people.

In addition, CBO uses the CPI-X, the experimental Consumer Price Index, to adjust its income figures for inflation for years before 1983. For further information on CBO data and methodology, see Committee on Ways and Means, pp. 1070-1, and 1163-7.

The data in this section are drawn from Committee on Ways and Means, pp. 1188, 1194.

[5]*Ibid.*, p. 1167. The CBO data show that for the top one percent of the population, the large increases in capital gains income between 1980 and 1990 account for 39 percent of the total increase in before-tax income received during this period. Another 38 percent of the increase in before-tax income received by this group is projected to come from increased wages and salaries, while 10 percent will come from increases in self-employment income. Some 10 percent will come from increases in other forms of investment income. For all of these forms of income, the increase accruing to the average family in the top one percent is larger -- in both dollar and percentage terms -- than the increase received by the average family in the bottom 90 percent. However, the disparity is greater for capital gains income than for any of the other forms of income.

These figures reflect the fact that most low and middle income households have no capital gains income in a typical year. Another recent CBO analysis projected that in 1991, some 68 percent of the wealthiest one percent of taxpayers will have capital gains income -- but only seven percent of those in the middle fifth and two percent of those in the poorest fifth will receive such income.[6] In addition, middle income households that do have capital gains income typically receive far smaller amounts of this income than very wealthy households do.

As a result, capital gains income will account for 32 percent of the income of the richest one percent of households in 1990, but for only one percent of the income of the bottom 90 percent of the population.

Table II
Changes in Average Household Income from Capital Gains, 1980-1990, By Various Income Groups

National income category	1980	1990 (projected)	change: 1980-90 ($)	change: 1980-90 (%)
Bottom 90 percent	$ 287	$ 299	$ 12	4.2%
Richest one percent	82,946	175,536	92,590	111.6

Source: Congressional Budget Office

Changes in Federal Tax Burdens

The data in the first section of this analysis reflect changes in *before*-tax income. The CBO data also cover recent changes in federal tax policy and in *after*-tax income. After-tax income represents the best measure of the income actually available to a household to meet its needs.

These data show that at the same time disparities in before-tax incomes were growing, federal tax burdens on lower income households were being increased -- while tax burdens on upper income households were being reduced.

[6] Congressional Budget Office, "Distributional Effects of the Administration's Capital Gains Proposal," March 5, 1990, pp. 2-3.

- From 1980 to 1990, the percentage of income that the poorest fifth of households pays in major federal taxes -- including income, payroll, and excise taxes -- is projected to rise 16 percent. The percentage of income paid in taxes by the very poorest group -- the bottom tenth -- is projected to rise 28 percent.

- Over this same period, the percentage of income paid in taxes by the middle fifth of households will edge up one percent.

- But the percentage of income paid in federal taxes by upper income households has declined. The percentage of income paid in taxes by those in the top income fifth will drop six percent from 1980 to 1990. For the wealthiest one percent of households, the percentage of income paid in federal taxes will fall 14 percent.[7] (See Table A-I at the back of the report.)

Pechman Found Tax Policy Contributing to Growing Income Disparities

A study by the late Joseph Pechman underscores the contribution of changes in tax policy to the growing gap between wealthy and other Americans.[8]

In his 1989 presidential address to the American Economic Association, Pechman demonstrated that the tax burden on the wealthiest Americans has fallen substantially over the past several decades. Using data from the Internal Revenue Service, Pechman found that in 1966, the top five percent of taxpayers paid an average of 33 percent of their incomes in federal, state and local taxes. By 1988, they were being taxed at a rate of 27 percent.

Tax rates fell even further for the richest one percent of taxpayers. They paid 40 percent of income in tax in 1966, but 27 percent in 1988. Over this period, their effective tax rate was reduced by one-third. By contrast, Pechman found that over this 22-year period, the percentage of income paid by other income groups changed relatively little.

The steeply reduced tax burden on the wealthiest Americans aggravated the already wide and growing gap between wealthy and other Americans, Pechman found. "The inescapable conclusion is that the well-to-do in our society have had very large reductions in tax rates in recent years, while the tax rates at the low and middle income levels have not changed much. Since the before-tax distribution has become much more unequal in the 1980s, it follows that inequality has increased even more on an after-tax basis."

---

[7]In another recent analysis, CBO found that if federal tax rates in 1990 were the same as they had been in 1980, the bottom four-fifths of taxpayers would pay less in federal taxes, while the top fifth would pay somewhat more, and the top one percent would pay considerably more. Congressional Budget Office, data provided to the Committee on Ways and Means at the request of chairman Dan Rostenkowski, March 7, 1990, Table 1.

[8]Joseph A. Pechman, "Why We Should Stick with the Income Tax," *The Brookings Review*, Spring 1990, pp. 10-11.

Growing Disparities in After-Tax Income

These changing tax burdens have widened still further the already large disparities in after-tax income between wealthy Americans and the rest of society.

- The CBO data show that from 1980 to 1990, the average *after*-tax income of the poorest fifth of households is projected to fall five percent, after adjusting for inflation. Among the poorest tenth of households, after-tax income is projected to fall an average of 10 percent.[9]

- For the middle fifth of households, there has been little change in after-tax income. These households will experience a gain in after-tax income of less than three percent -- or $660 -- over this 10-year period.[10]

- By contrast, the top fifth of households will realize an average gain in after-tax income of 33 percent.

- Most striking are the income gains garnered by the richest one percent of Americans. Their average after-tax income *will rise 87 percent* from 1980 to 1990, after adjusting for inflation. CBO projects that the average after-tax income of these households will reach $400,000 in 1990, up from $214,000 in 1980.[11] (See Table A-2.)

Disparities in after-tax income have widened so much in recent years that by 1990, the top one percent of the population will have nearly as much after-tax income as the bottom 40 percent. Stated another way, the combined incomes of the richest 2.5 million Americans now nearly equal the combined incomes of the 100 million Americans with the lowest incomes.[12] This marks a sharp change from

---

[9] Committee on Ways and Means, pp. 1189, 1194.

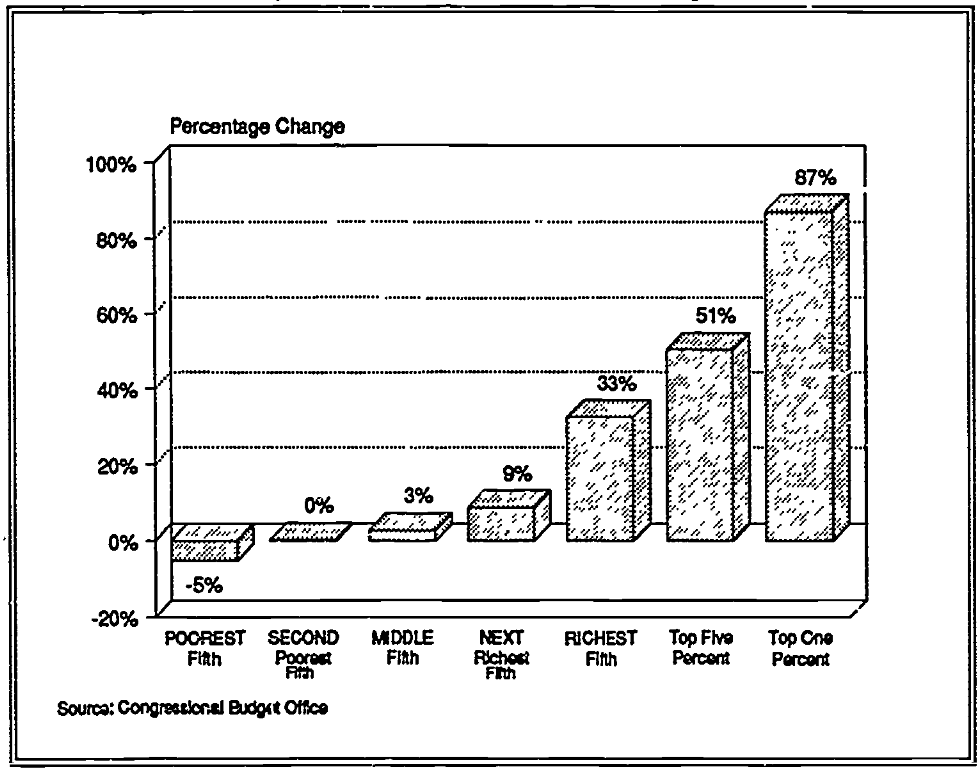
[10] Some researchers have found that a significant fraction of this small income gain has occurred because more mothers in two-parent households are working, and also that much of the gain these households have achieved has been consumed by additional commuting and child care costs. See, for example, Democratic Study Group, "They Didn't Come to the Party: A Tough Decade for Families in the Middle," July 1990.

[11] *Ibid.*, p. 1189.

[12] More precisely, in 1990, the combined income of the 2.5 million Americans with the highest incomes will equal the total income of the 93 million to 94 million Americans with the lowest incomes.

1980, when the top one percent received *half* as much after-tax income as the bottom 40 percent.[13]

Figure 1
Average After-Tax Income Gains and Losses Between 1980 and 1990, By Various Household Income Groups



The growth in the incomes of the richest one percent of Americans has been so large that just the *increase* between 1980 and 1990 in the after-tax income of this group equals the *total* income the poorest 20 percent of the population will receive in 1990. In other words, the increase in the after-tax income of the richest 2.5

[13]*Ibid.*, p. 1181. CBO estimates that the bottom two-fifths of households will receive 14.2 percent of the total after-tax income received by all income groups in 1990, while the top one percent of households will receive 12.6 percent. In 1980, the bottom two-fifths received 16.8 percent of the national income while the top one percent of households received 8.3 percent.

million Americans between 1980 and 1990 will equal the total income that the 50 million Americans with the lowest incomes will receive this year.[14] (See Table III.)

Disparities have also widened between the wealthy and the middle class. In 1980, the total amount of after-tax income going to the 60 percent of households in the middle of the income spectrum (that is, all households except those in the poorest and richest fifths) was 12 percent greater than the income going to the wealthiest fifth of households. By 1990, however, the income going to the middle three-fifths will be seven percent less than that received by the top fifth.

In fact, CBO figures show that in 1990, *the top fifth will receive as much after-tax income as the other 80 percent of the population combined.*

Another comparison further illustrates this point. In 1980, the total amount of after-tax income received by the top 5 percent of households was modestly larger than that received by the 20 percent of households right in the middle of the income scale. In 1990, the top five percent of households will receive nearly *twice as much* income as the middle 20 percent of households.

In short, during the 1980s, the shares of both before-tax income and after-tax income declined for every income quintile except one -- the households in the top fifth.[15]

Data issued by the Census Bureau reflect a similar trend, although these data reflect before-tax income only. The Census data show that in 1988, the share of the national income going to the wealthiest fifth of families was larger than in any other year since the Census Bureau began collecting these data in 1947. (1988 is the latest year for which these data are available.) By contrast, the share of national income going to the middle fifth of families was lower than at any time since the Bureau began collecting these data more than four decades ago, whi' the share going to the bottom fifth was tied for the lowest since 1954.[16]

---

[14] *Ibid.*, p. 1181. From 1980 to 1990, the share of the national after-tax income accruing to the top one percent of households will rise from 8.3 percent to 12.6 percent. The bottom fifth of households is projected to receive 4.3 percent of the national after-tax income in 1990.

[15] *Ibid.*, pp. 1180-1.

[16] It should be noted that Census data recognize only the first $299,999 of a family's income. If a family has income above that level, the family is recorded as having income of exactly $299,999. As a result, income above that level is not counted as part of the share of income going to the top fifth. If the Census data did reflect income above $299,999, the distribution of national income in any year would be shown to be more unequal.

(continued...)

Table III
Change in Distribution of Total U.S. After-Tax Income, 1980-1990

National income category	1980	1990 (projected)
Poorest fifth	5.4%	4.3%
Next poorest fifth	11.4	9.9
Middle fifth	16.2	14.9
Next richest fifth	22.6	21.7
Richest fifth	44.8	49.9
Richest five percent	19.6%	25.0%
Richest one percent	8.3	12.6

Source: Congressional Budget Office

These Census data indicate that the gaps between both the rich and the poor and the rich and the middle class are wider now than at any other time since the end of World War II.

Policy Changes that Would Exacerbate These Trends

Several pending policy proposals would accelerate these trends and make income disparities between wealthy and other Americans still greater. The principal such proposal is the capital gains tax cut.

---

[16](...continued)

The late Joseph Pechman observed in his 1989 presidential address to the American Economics Association, Census data "greatly understate the *increase* in inequality that has occurred during the 1980s." Over the course of the 1980s, Pechman reported, the incomes of the wealthy -- particularly the top one percent of the population -- increased at a much more accelerated pace than the incomes of other Americans. Because the Census data on income distribution do not count family income above $299,999, the data miss most of the sharp increase in income at the very top of the income scale.

Even though the Census data miss some of the increase in inequality, however, they still show the income gaps between the top and the bottom fifths -- as well as the gap between the top and the middle fifths -- to be wider than at any other time on record.

As noted, the bulk of capital gains income accrues to the very wealthy. As a result, very affluent individuals would receive most of the benefits from a reduction in taxes on capital gains income.

Earlier this year, the respected Joint Committee on Taxation undertook an analysis of the distribution of tax benefits that would result from the most prominent proposal to reduce the capital gains tax, the proposal submitted by the Bush Administration.[17] The Committee found:

- More than 94 percent of the benefits from the capital gains tax cut would go to the top fifth of taxpayers. The richest three percent of taxpayers -- those with incomes of $100,000 or more -- would capture more than 83 percent of the tax benefits. (See Figure 1.)

- The top one percent of taxpayers -- those with incomes of at least $200,000 -- would receive approximately 66 percent of the benefits.

  Those taxpayers with incomes of more than $200,000 who would benefit from the cut would receive an average tax reduction of more than $15,000 apiece.

- By contrast, the middle three-fifths of taxpayers would receive less than six percent of the benefits from the capital gains proposal.

- Virtually none of the benefits would go to the poorest fifth of taxpayers.[18]

The Joint Committee's analysis also shows that the proposed capital gains tax cut would result in significant losses of federal revenue. While the proposal would temporarily boost federal revenue in fiscal years 1990 and 1991 as taxpayers

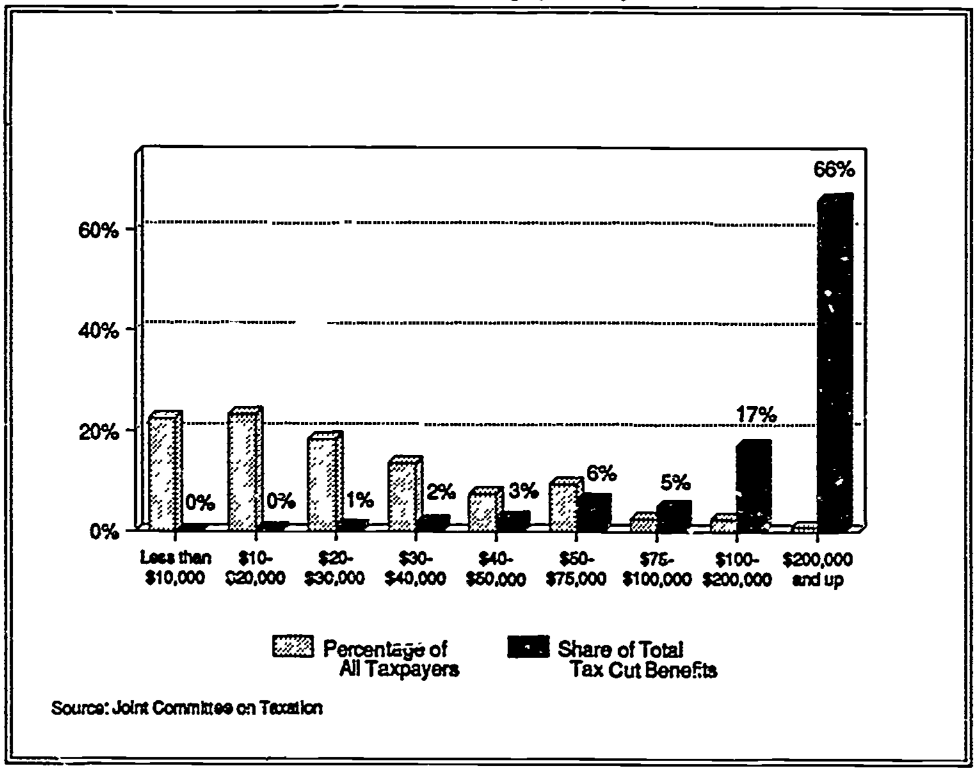
---

[17]Joint Committee on Taxation, "Estimate of Administration Proposal for A Reduction in Taxes in Capital Gains on Individuals (JCX-5-90)," February 14, 1990. This document provides data on the distribution of the tax benefits from the capital gains proposal among taxpayers in different income brackets. Data on the proportion of taxpayers in each income bracket are from Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 1990-1994*, February 28, 1989. Both sets of data reflect 1990 income levels.

A modest fraction of the tax units described here and in the section on Individual Retirement Accounts do not pay federal income taxes. Most of those tax units not paying federal income taxes are exempt from such taxes because of their low incomes.

[18]A study by the Congressional Budget Office, *Distributional Effects of the Administration's Capital Gains Proposal* (March 5, 1990), reached similar conclusions to those of the Joint Tax Committee. CBO estimated that the top fifth of taxpayers would receive over 95 percent of the benefits from the capital gains tax cut proposal, and the top one percent would receive 59 percent of the benefits. The middle three-fifths of taxpayers would receive less than five percent of the benefits, and the bottom fifth would receive none.

Figure 2
Distribution of Capital Gains Tax Cut Benefits
and Distribution of U.S. Taxpayers, By Income Level



cashed in assets to benefit from the new tax break, the long-term revenue effects would be adverse. In the four years after fiscal year 1991, the Administration's proposal would cause a loss in revenue estimated at $15.3 billion.[19] The Joint Committee noted that the proposal would generate further substantial revenue losses in the years beyond 1995 but did not estimate the level of these losses.

The revenue losses from a capital gains tax cut would likely result in a further widening of income gaps -- and in income losses for average low and middle income households. Due to Congressionally mandated deficit limits under the Gramm-Rudman-Hollings law, legislative proposals that reduce revenues must eventually be offset by spending cuts or tax increases. If a capital gains tax cut

[19]Over the five-year period from fiscal year 1990 through fiscal year 1995, there would be a net revenue loss of $11.4 billion. Joint Committee on Taxation, "Estimate of Administration Proposal for A Reduction in Taxes in Capital Gains on Individuals (JCX-5-90)," February 14, 1990, page L-2.

were financed by reductions in federal programs that primarily serve low or middle income people, or by tax increases not targeted at high income taxpayers, the net effect would be to reduce the incomes of low and middle income households -- and to transfer income from these households to those at the top of the income scale.

In addition, a cut in federal taxes on capital gains income could be followed in a number of states by a similar cut in state capital gains taxes. In many states, tax policy is largely modeled on federal tax policy. If the Administration's capital gains tax cut is enacted, some of these states would likely cut their own capital gains taxes. Wealthy taxpayers in these states who had capital gains income thus would benefit from both lower federal taxes and lower state taxes.

Several other tax cut proposals before Congress would also direct most of their benefits to upper income groups, although not to the extent the capital gains proposal would. For example, a proposal to restore tax deductibility for contributions made to Individual Retirement Accounts by single taxpayers with adjusted gross incomes above $35,000 and couples with incomes above $50,000 would confer at least 95 percent of its benefits on those in the top income fifth. The other four-fifths of taxpayers would receive the remaining five percent of the benefits.[20]

---

[20]Under current law, single tax filers with adjusted gross incomes over $35,000 and joint filers with incomes over $50,000 may not deduct contributions to IRA accounts if they participate in an employer-sponsored retirement plan. Prior to passage of the Tax Reform Act of 1986, IRA contributions made by such taxpayers were deductible. Several proposals have been introduced to restore deductibility for IRA contributions made by taxpayers above the $35,000 and $50,000 limits. The particular proposal cited here was introduced by Senator Lloyd Bentsen (D-Texas), the chairman of the Senate Finance Committee. In addition to restoring deductibility, the Bentsen plan would also allow penalty-free withdrawals from IRA's to pay costs associated with higher education or the purchase of a first home.

While the IRA proposal would confer at least 95 percent of its benefits on the top fifth of taxpayers, it would be significantly less skewed towards the very wealthy than a capital gains tax cut would. Some 83 percent of the benefits from the Administration's capital gains tax cut would go to taxpayers with incomes of at least $100,000. Some 31 percent of the IRA benefits would go to those in this income bracket. Similarly, while 66 percent of the capital gains benefits would go to taxpayers with incomes of $200,000 or more, a comparatively low proportion of the IRA benefits -- six percent -- would go to these taxpayers. The bulk of the IRA benefits would go to those in the $50,000 to $100,000 income range. (Most households in the $50,000 to $100,000 range are in the top fifth of the income distribution; none of these households are in the top one percent.)

The figures cited here on the distribution of IRA tax benefits by income bracket were derived by taking Joint Committee on Taxation data on the distribution of IRA tax benefits by income level and matching these data with other Joint Committee data on the number of taxpayers in each income bracket. The latter data are published in the Joint Committee publication, *Estimates of Federal Tax Expenditures for Fiscal Years 1990-1994*, February 28, 1989.

Since this proposal would lose substantial amounts of revenue, it would need to be accompanied by budget cuts or other tax increases.[21] As a consequence, it would likely result in net income losses for low and middle income households.

The Administration's proposal to establish Family Savings Account similarly would be of primary benefit to those in the top income fifth. The Congressional Budget Office has found that taxpayers with incomes of more than $50,000 would be its principal beneficiaries.[22] Under this proposal, married tax filers could deposit up to $5,000 per year and retain all the interest tax-free if they did not withdraw the funds for seven years.[23] This proposal, too, would entail losses to the Federal Treasury that would have to be made up elsewhere.[24]

* * * * *

During the 1980s, disparities in before-tax income grew significantly. Instead of ameliorating this trend, however, public policy exacerbated it. A fundamental question facing the nation in the 1990s is whether public policies will again contribute to this trend and make income disparities even larger than they already are -- or whether public policy will change and chart a different course.

---

[21]The Joint Committee on Taxation has estimated that the IRA proposal discussed here would lose $15.4 billion over five years.

[22]Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal year 1991*, March 1990, p. 44. The Administration's proposal would limit eligibility for Family Savings Accounts to married filers with adjusted gross income below $120,000 and to single filers with adjusted gross income below $60,000. However, Treasury Department data show that in 1985, the most recent for which these data have been published, only two percent of all taxpayers filing joint returns had incomes exceeding $100,000. An income of $120,000 in 1991 is roughly equivalent to an income of $100,000 in 1985. Thus, most of those in the top fifth of taxpayers would be eligible for the Family Savings Accounts, although the very richest households would not be.

[23]Single filers could deposit up to $2,500 per year and receive the same tax break.

[24]According to the Joint Committee on Taxation, The Administration's proposal to establish Family Savings Accounts would cause a revenue loss of $5 billion between fiscal years 1991 and 1995, including a loss of $1.8 billion in fiscal year 1995 alone.

Appendix

Comparing 1980 to 1990

In this analysis, we use the years 1980 and 1990 as our comparison points in order to examine changes in income distribution during the 1980s. Most of the CBO data reflected in this report are available for four years: 1977, 1980, 1985, and 1990.

If 1977 is chosen as the comparison year instead of 1980, and income shifts from 1977 to 1990 are studied, the results are similar to those presented here, although income disparities widened somewhat more between 1977 and 1990 than between 1980 and 1990. From 1980 to 1990, for example, the average after-tax income of the top fifth of the population is projected to grow 32.5 percent in inflation-adjusted terms. From 1977 to 1990, it will grow 34.8 percent. Similarly, the average after-tax income of the bottom fifth is projected to fall 5.2 percent from 1980 to 1990, and 10.1 percent from 1977 to 1990.

Most of the change in the distribution of after-tax income that occurred between 1977 and 1990 occurred during the 1980-1990 period. The bottom fifth of the population had 5.7 percent of the national after-tax income in 1977 and 5.4 percent in 1980 -- but will have just 4.3 percent in 1990. The middle fifth had nearly identical shares of the national income in 1977 and 1980 -- 16.3 percent in 1977 and 16.2 percent in 1980 -- but will receive a significantly smaller share, 14.9 percent, in 1990. The share received by the top fifth rose from 43.9 percent in 1977 to 44.8 percent in 1980, but the biggest growth came between 1980 and 1990. In 1990, the top fifth will receive 49.9 percent of the national income.

Finally, the patterns on capital gains income discussed here are generally similar for the 1977-1990 and 1980-1990 periods. As noted in the report, the

capital gains income of the average household in the top one percent of the population will rise $92,000 from 1980 to 1990, after adjusting for inflation, while the capital gains income of the average household in the bottom 90 percent of the population will rise just $12. Between 1977 and 1990, the capital gains income of the average household in the top one percent will rise about $111,000, while the average household in the bottom 90 percent will receive an increase in capital gains income of $34.

Table A-1
Changes in Average Federal Tax Burdens on Households, 1980-1990, By Various Income Groups

National income category	1980	1990 (projected)	change: 1980-90
Poorest tenth	6.7%	8.5%	27.7%
Poorest fifth	8.4%	9.7%	16.1%
Next poorest fifth	15.7	16.7	6.0
Middle fifth	20.0	20.3	1.2
Next richest fifth	23.0	22.5	-2.2
Richest fifth	27.3	25.8	-5.5
Richest five percent	29.5%	26.7%	-9.5%
Richest one percent	31.8	27.2	-14.4

Source: Congressional Budget Office

Table A-2
Changes in Average After-Tax Household Incomes, 1980-1990, By Various Income Groups

National income category	1980	1990 (projected)	change: 1980-90 ($)	change: 1980-90 (%)
Poorest fifth	$ 7,357	$ 6,973	$ -384	-5.2%
Next poorest fifth	16,088	16,124	36	0.2
Middle fifth	24,031	24,691	660	2.7
Next richest fifth	32,075	34,824	2,749	8.6
Richest fifth	58,886	78,032	19,146	32.5
Richest five percent	$ 100,331	$ 151,132	$ 50,801	50.6%
Richest one percent	213,675	399,697	186,022	87.1

Source: Congressional Budget Office

If you have found this publication useful and would like to receive future Center materials, you may subscribe to the Center's Publication Service by using the form at the right.

Cut along this line

Please enter my subscription as follows:
(PLEASE PRINT)

Name: ______________________________
Organization: ______________________________
____
Address: ______________________________
______________ Zip: ______________
Telephone: (____) ______________________________

______ Basic Package - $25 for a one-year subscription. Includes all poverty and income reports and analyses and all budget analyses.

Plus all reports and analyses on:
(Choose One)

______ Labor issues, including employment, unemployment insurance, minimum wage.

______ Hunger and welfare issues, including food and nutrition programs.

______ Low income housing issues, based on major new data being released.

______ Comprehensive Package - $40 for a one-year subscription. Includes all poverty and income reports, all budget analyses, and all reports and analyses on all three topics above.

______ My check is enclosed, payable to Center on Budget and Policy Priorities.

______ Please bill me.

Send this form and your payment:

Publications Service
Center on Budget and Policy Priorities
777 N. Capitol Street, N.E. Suite 705
Washington, DC 20002
(202) 408-1080